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GOVERNMENT

Helping hand is lent to the state

Retail sale of tax bonds draws broad interest

BY WILLIAM HAMILTON

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Jose Severino harbors no grudge toward the Carcieri administration for changing state retiree benefits to cut costs, a move that nudged him and hundreds of state workers into retiring in September.

He understands that state leaders are facing some debilitating fiscal problems. In fact, when Severino learned that the state was offering tax-free, short-term bonds to residents and businesses late last month, he decided to try and help ease those fiscal woes.

Severino was one of the members of the public who last week purchased a combined \$25 million worth of the so-called tax anticipation notes (TANs) that are intended to address the state's immediate cash flow needs.

While the state has done similar borrowing in previous years, including the preceding two fiscal years, such bond sales typically had been reserved exclusively for institutional investors.

Indeed, most of the \$350 million in notes issued by the state last week — which allow government to finance its operating expenses in advance of tax revenue it expects to collect in the spring — were snapped up by large institutions.

But R.I. General Treasurer Frank T. Caprio took the unusual step of offering

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the bonds to retail buyers because he was concerned that with the turmoil in the municipal debt market, this kind of investment wouldn't attract a sufficient number of large-scale investors.

A month earlier, the municipal debt market was nearly frozen because investors had grown skittish, leaving borrowers with good bond ratings struggling to drum up interest in their offerings.

Before last week's sale, Caprio characterized the TANs as a way for residents to assist the state until tax revenue comes in.

That is, in part, why Severino visited a Bank of America branch in downtown Providence on Monday, Oct. 27 to purchase more than \$50,000 in TANs.

"I'm part of this state," Severino, 56, of Providence, explained last week. "I wanted to contribute. I wanted to make sure that the state flourishes."

He acknowledged that he also likes that, despite the small 2.20 annual percentage yield on the eight-month bond, it offers tax-exempt interest.

It was unclear late last week just how many retail customers such as Severino purchased the TANs, but Bank of America reported that at least 150 new accounts for retail investors were opened after news of the unusual offering spread across the state.

The amount sold directly to Rhode Island residents caught state officials by surprise.

Gov. Donald L. Carcieri said days before the notes became available that he did not expect a significant amount of the money to come from citizens, saying that \$2 million would be an optimistic prediction.

Even Caprio—talked about in political circles as a potential gubernatorial candidate—who developed the plan to offer the notes at the bank branches, projected that residents would buy between \$10 million

and \$20 million.

In hindsight last week, Caprio figured people's desire to find a stable place to park their money in uncertain times led to the higher-than-expected turnout. But in the feedback his office received, "a slice of the responses were about helping the state," Caprio said.

In order to make it easier for retail investors to purchase the TANs, Caprio made them available at several Bank of America branches in the state, and he lowered the minimum investment from \$10,000 to \$1,000 per bond. Retail buyers were also given priority when the offering started.

It appears those changes were successful in attracting interest.

In little more than an hour after it started, the sale was oversubscribed, with two investors for every bond available, according to Caprio.

The treasurer's office also said Wall Street trading-desk reports indicated that the retail interest was "felt by institutional investors." That in turn drove down the yield for the TANs.

'I wanted to contribute. I wanted to make sure that the state flourishes.'

JOSE SEVERINO

Retired state worker

The state had already set aside \$1.9 million from general revenue and planned to use another \$4.8 million raised from the TANs themselves to pay bondholders, according to the state budget. But because of the lower-than-expected yield, the debt service costs were reduced by \$3.3 million.

The treasurer's office touted the success of last week's offering, drawing a comparison with California's sale of \$5 billion in revenue anticipation notes last month. In that case, the notes were also made available to retail investors, but the yields were much higher: 3.75 percent and 4.25 percent for notes that mature in May and June respectively.

Rhode Island's interest rate matched

what Massachusetts obtained when it sold \$750 million in revenue bonds in early October. But the 2.20-percent rate was obtained only after Massachusetts delayed the sale twice because of uncertainty in the municipal debt market.

Caprio said the wide range of interest rates illustrates how volatile the markets are from day to day. Over the weekend before Rhode Island's offering, state officials thought the interest rate might have to be set at about 4 percent because major investors weren't showing interest. Caprio contemplated postponing the sale.

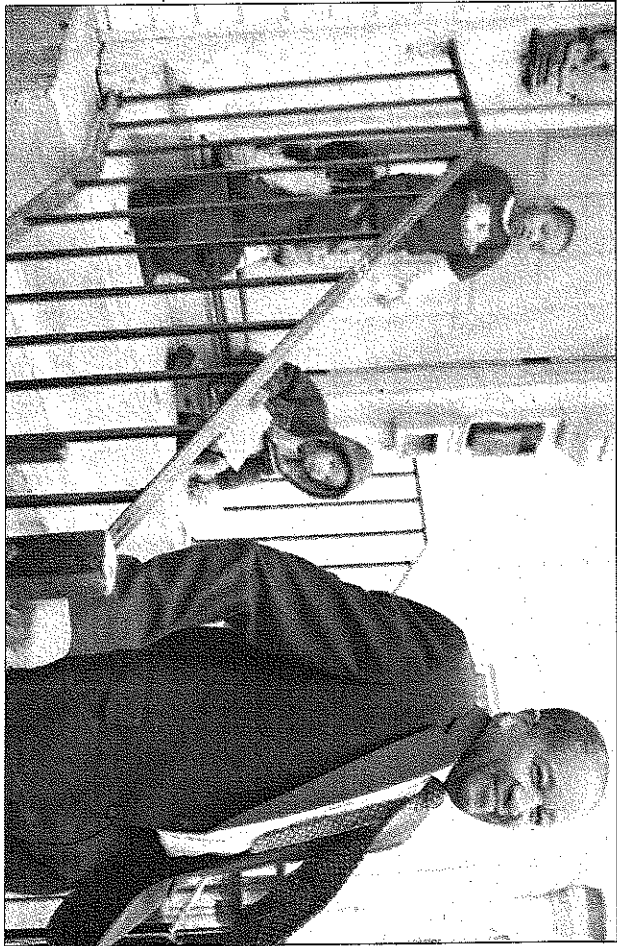
By the morning of Oct. 27, Caprio said, retail investors were showing up at Bank of America branches, asking about buying TANs. "That set a good tone with the institutions," he said, in part because the large investors figured the strong interest meant they could re-market the TANs they purchased to individuals at a lower rate.

The state went forward with the offering, which Caprio said turned out to be good timing. The next day "was a difficult day in the market," he said.

For those who purchased the Rhode Island TANs last week, the notes are due to mature on June 20, 2009—the last day of

DOING HIS PART: Jose Severino bought more than \$50,000 in tax anticipation notes offered by the state. "I don't want to see the state go belly up," he said.

PBN PHOTO/VICTORIA AROCHO



the fiscal year.

While the lower yield is good for the State of Rhode Island, it means a smaller return for those who purchased the TANs. A certificate of deposit with a similar term generally features a higher annual percentage yield.

For instance, Citizens Bank, which has the largest deposit market share in Rhode Island, offers six-month CDs with an APY ranging from 3.25 to 3.75 percent. The difference: Interest derived from TANs is exempt from state and federal taxes.

"I felt it was a good deal," said Severino of his decision to invest in the Rhode Island notes. "Nobody's making money anyplace else, anyway."

But his return on investment wasn't the only deciding factor.

Severino, who worked for the R.I. Department of Human Services for 28 years, retiring as a supervisor in the child-care division in September, also wanted to do his part in helping Rhode Island through rough times.

"I don't want to see the state go belly up," he said. "And if you're not part of the solution, you may be part of the problem." ■